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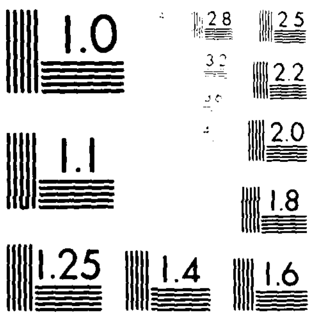

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BY THE COMPTROLLER GENERAL

Report To The Congress

OF THE UNITED STATES

Tax Revenues Lost And Beneficiaries Inadequately Protected When Private Pension Plans Terminate

Many terminating private pension plans are not voluntarily requesting the Internal Revenue Service (IRS) reviews for protecting participants' rights to benefits, and termination actions are not being reported to the Pension Benefit Guaranty Corporation--the agency responsible for insuring payments. Also, IRS processes for collecting taxes due on pension asset disbursements are incomplete and millions in tax revenues have been lost. The Corporation and IRS have initiated actions to correct some of these problems, but more needs to be done.

The Congress should amend the Internal Revenue Code to require sponsors of terminating pension plans to obtain an IRS review of participant protection requirements before plan dissolution. IRS should improve reviews of pension plan terminations and disbursements, and the Corporation, in cooperation with IRS, should establish procedures for timely identification and followup actions on unreported plan terminations.

UNITED STATES GENERAL ACCOUNTING OFFICE

HRD-81-117

SEPTEMBER 30, 1981

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COMPTROLLER GENERAL OF THE UNITED STATES
WASHINGTON D.C. 20548

B-203672

To the President of the Senate and the
Speaker of the House of Representatives

This report discusses ways the Internal Revenue Service and the Pension Benefit Guaranty Corporation can improve the identification and processing of private pension plan terminations to help ensure plan participants and their beneficiaries receive their entitled pension benefits. It also discusses ways the Internal Revenue Service can help ensure employers and participants are reporting one-time lump-sum pension asset disbursements for tax purposes.

We performed this review at the request of the Chairman of the Subcommittee on Oversight, House Committee on Ways and Means.

We are sending copies of this report to the Director, Office of Management and Budget; the Commissioner of Internal Revenue; the Executive Director of the Pension Benefit Guaranty Corporation; and other interested parties.

Milton J. Socolar

Acting Comptroller General
of the United States

COMPTROLLER GENERAL'S REPORT TO THE CONGRESS

TAX REVENUES LOST AND BENEFICIARIES INADEQUATELY PROTECTED WHEN PRIVATE PENSION PLANS TERMINATE

D I G E S T

The Internal Revenue Service (IRS) and the Pension Benefit Guaranty Corporation have not been effective in helping ensure that participants obtain entitled benefits when private pension plans terminate. The Chairman of the Subcommittee on Oversight, House Committee on Ways and Means asked GAO to review the effectiveness of these agencies' efforts to protect participants in private pension plans and to insure proper disclosure of plan asset disbursements for tax purposes.

GAO's analysis for 1977 showed that, for about two-thirds of reported terminations, plan sponsors were not requesting IRS reviews at the time of termination because they are not mandatory under the Internal Revenue Code. Termination actions were not being reported to the Corporation, which is responsible for insuring participants' benefits. Thus, at the time of termination there is no assurance that, for many such plans, the participants are adequately protected as required by the Employee Retirement Income Security Act (ERISA) and the Internal Revenue Code.

Further, IRS reviews of terminating pension plans requested by plan sponsors have not been effective in protecting participants' benefits, and IRS processes for collecting taxes due on plan asset disbursements are incomplete. Substantial tax revenues--$9.6 million for tax year 1976 alone--have been lost because IRS had not fully compared employer and employee tax reporting information on asset disbursements to individuals. The Corporation and IRS have begun actions to correct some of these problems, but more needs to be done.

IRS SHOULD MAKE MORE COMPLETE REVIEWS OF PENSION PLAN TERMINATIONS

IRS reviews of private pension plan termination actions have not assured that terminating plans conform to ERISA and the Internal Revenue Code requirements, which are designed to protect participants' benefits. Guidelines for IRS reviews

SEPTEMBER 30, 1981

have been fragmented and often they are unclear on the purpose or objective to be sought by IRS reviewing officials. As a result, terminating plans have been reviewed and favorable determinations of conformance rendered by IRS without:

--Information necessary to determine whether plans are qualified.

--The plans having met requirements established under ERISA and the Internal Revenue Code to protect participant benefits.

--Resolving reported discrepancies or questionable plan operations. (See pp. 7 to 18.)

IRS reviews had been completed without adequately addressing (1) inconsistent termination dates reported by pension plan administrators, (2) potentially incorrect asset distributions, (3) discrepancies in reported plan assets or eligible plan participants, and (4) possible loss of benefits by participants after many years of service because of termination of employment. Without further pursuit of these issues, through inquiries with plan administrators and participants and requests for substantiating documentation, IRS did not assure that plan participants were treated equitably.

GAO discussed these problems with IRS headquarters officials. Subsequently, IRS developed (1) an agency training course covering termination reviews and (2) new procedures for IRS reviewers to use in identifying plan problems and issues to be pursued. These developments should help to alleviate many of the processing weaknesses GAO identified; however, additional criteria for guiding IRS review efforts are needed. (See pp. 17 and 18.)

BETTER GOVERNMENT PROCEDURES NEEDED TO IDENTIFY UNREPORTED PLAN TERMINATIONS FOR REVIEW

IRS improvement of reviews of terminating private pension plans will not, of itself, assure that the participants of terminating plans are adequately protected. IRS reviews before termination are not mandatory, and thousands of sponsors have elected not to subject their plans to an IRS review at termination or have waited long time periods, even

years, after terminating their plans before requesting an IRS review. Delays or inaction reduce the opportunity for identification and correction of plan problems to help assure participants' benefits are protected. Timing is critical to assure Government and participant involvement in decisions on the distribution of assets.

At termination, plan sponsors may self-determine whether their pension plan actions conform to participant protection requirements of ERISA and the Internal Revenue Code or they may request IRS to determine whether their actions conform. For plans that conform, plan sponsors and their participants are eligible for preferential tax treatment.

IRS has been concerned that plans which have not voluntarily requested its review--at some point during the plan's operation life or at termination--are more likely not to meet ERISA and Internal Revenue Code requirements. IRS has examined and plans to continue examinations (audits) of plans that do not request IRS reviews in an effort to mitigate potential problems with unreported plan noncompliance. However, the length of time required for IRS to identify the occurrence of a plan termination means that these examinations ordinarily cannot be made until several years after the plans terminate. This does not provide plan participants with the advantages and benefit protection that an IRS review before termination would provide. Timely recognition and review of terminations by IRS can provide greater assurance that:

--Plans meet ERISA and the Internal Revenue Code participant protection requirements and are tax qualified.

--Participant benefits will be guaranteed by the Corporation under ERISA's termination insurance programs.

--Plan participants have a vehicle to protect their own interests through direct involvement in the sponsors termination actions.

--Less future Government effort will be spent in making detailed examinations of plans years after termination. (See pp. 21 to 25.)

Thousands of pension plans terminated since the enactment of ERISA without requesting an IRS review or in some cases without notifying the Corporation. The Corporation and IRS initiatives directed at obtaining more accurate and timely data on plan terminations have met with limited success because of difficulties in developing reliable computer data on plans that have terminated and reluctance to use faulty data to contact pension plans to determine their status. These difficulties have militated against the effective use of staff and available resources, and a more coordinated effort using Federal automated records is needed. Requiring pension plans to obtain an IRS review before plan dissolution as a basis for tax qualification should better protect participants' benefits and improve reporting of plan terminations. (See pp. 25 to 27.)

IMPROVED OVERSIGHT OF PENSION ASSET DISBURSEMENTS COULD INCREASE TAX REVENUE

Many employees or their beneficiaries receive one-time lump-sum distributions of plan assets (called pension payouts) before their retirement years when pension plans are terminated, employees terminate employment, or employees die or become disabled. During tax year 1976, the most recent year for which total IRS data were available, about 2 million individuals discontinued participation in pension plans and received an estimated $6 billion in pension payouts. IRS procedures for identifying and processing tax compliance information on recipients of these payments have not been adequate. Pension payouts are taxable when received as ordinary income or capital gains unless the recipient elects to reinvest the sum received in another qualifying pension plan.

Although IRS made $4.3 million in tax assessments for unreported pension payouts in tax year 1976, IRS did not process most of the employer pension payment documents it received, and it had not developed a method for assuring that employers are filing required forms. If pension payouts are not processed by IRS for the year received there is little likelihood the one-time payments will ever be reviewed. The full loss from not processing pension payouts could not be determined from IRS records. However, GAO found that (1)

$9.6 million in tax revenues were lost for tax year 1976 alone (2) IRS resources have been expended unnecessarily to manually screen thousands of individuals' income tax returns to reconcile apparent pension payout reporting discrepancies because IRS had not developed effective computer matching procedures. (See pp. 31 to 35.)

Before tax year 1980, IRS sampled about one-third of the pension payouts reported by employers as ordinary income above certain dollar tolerance levels for comparison with individual income tax returns. Unprocessed forms have been destroyed through tax year 1979. GAO discussed with IRS the potential for additional tax recovery through full processing of pension payouts. As a result, IRS initiated a program in 1981 providing for full matching of tax year 1980 pension payout filings reported by employers as ordinary income above certain dollar tolerances. GAO believes this is an important step and that additional tax recovery can be obtained by matching pension payout data reported by employers as capital gains. (See pp. 35 and 36.)

RECOMMENDATION TO THE CONGRESS

In support of ERISA and the Internal Revenue Code policies protecting the rights of pension plan participants to promised benefits, the Congress should enact legislation that would make pension plan determinations by IRS mandatory for tax qualification of terminating private pension plans before plan dissolution. (See p. 29.)

RECOMMENDATIONS TO THE EXECUTIVE DIRECTOR OF THE PENSION BENEFIT GUARANTY CORPORATION AND THE COMMISSIONER OF INTERNAL REVENUE

GAO recommends that the Executive Director, in cooperation with the Commissioner, use the automated records of both agencies to identify nonreporters of plan terminations and establish procedures for timely followup with the potential nonreporters to ensure participants in terminated plans, entitled to retirement benefit insurance, are afforded the protection intended by the Congress under ERISA. (See p. 29.) GAO makes several recommendations to the Commissioner of Internal Revenue to improve IRS reviews of pension plan

termination actions and the IRS processes for collecting taxes due for pension asset disbursements. (See pp. 18, 29, and 36.)

AGENCY COMMENTS

IRS and PBGC officials advised GAO that they agreed with the recommendations in this report. Comments they provided have been incorporated in appropriate sections of this report and are included in appendixes III and IV. (See pp. 18, 29, and 37.)

Contents

ABBREVIATIONS

ERISA	Employee Retirement Income Security Act
GAO	General Accounting Office
IRS	Internal Revenue Service
PBGC	Pension Benefit Guaranty Corporation

CHAPTER 1

INTRODUCTION

The establishment and continuation of privately sponsored pension plans for providing retirement income to American workers has long been encouraged through favorable tax treatment of the plans, their sponsors, and participants. Because of indicated misuse and abuse of pension plans, the Employee Retirement Income Security Act (ERISA) (29 U.S.C. 1001 et seq.) was enacted on September 2, 1974, to better protect the interests of plan participants.

To accomplish its overall purpose, ERISA established minimum standards and other requirements governing the design and operation of the plans. Plans have to meet these and related Internal Revenue Code requirements before they qualify for the favorable tax treatment. ERISA also established programs to guaranty the payment of certain benefits promised participants of defined benefit plans. These plans promise definitely determinable benefits based on such factors as years of employment, age, and compensation received. The benefits of such plans are insured by the Pension Benefit Guaranty Corporation (PBGC).

This report discusses PBGC's efforts to ensure terminating defined benefit plans are reported so that participants' benefits are covered by the insurance programs. It also discusses the Internal Revenue Service's (IRS') efforts to (1) identify and review pension plans that terminate without having been previously determined by IRS as meeting the requirements for favorable tax treatment, (2) review terminated pension plans to help ensure participants receive entitled benefits, and (3) ensure employers and participants are reporting one-time lump-sum pension payouts for tax purposes. We reviewed these matters in response to a November 1978 request from the Chairman of the Subcommittee on Oversight, House Committee on Ways and Means.

PENSION PLANS UNDER ERISA AND THE INTERNAL REVENUE CODE

Businesses originally established private pension plans to retain valuable employees, reduce labor turnover, and reward employees with many years of service. Although the development of private pension plans has largely resulted from business and labor initiative, the Federal Government has encouraged the growth of these plans through its tax laws. Essentially, the tax laws provided that (1) business contributions to pension plans are generally tax deductible, (2) earnings on the business contributions held by a pension plan are not taxed, and (3) employees do not have to pay taxes on the contribution made on their behalf to the pension plan and earnings on these contributions until the moneys are received.

For businesses to qualify for favorable tax treatment, pension plans have to comply with a general framework of standards provided under the Internal Revenue Code. In general, the standards require pension plans to

--be established and be operated for the exclusive benefit of employees;

--provide benefits in accordance with the provisions of the plans;

--provide benefits and pension coverage to employees that do not discriminate in favor of officers, shareholders, or highly compensated employees; and

--provide, upon termination or discontinuance of contributions to the plan, that employees' rights to benefits earned--to the extent funded--are nonforfeitable.

For fiscal year 1981, IRS estimates that over $23 billion in tax revenues will be foregone or deferred as a result of the favorable tax treatment.

ERISA, the first comprehensive Federal legislation regulating the internal workings of private pension plans, was enacted because of indications that pension plan misuse and abuse was resulting in lost pension benefits to employees, even those with many years of service. ERISA's purpose is to help ensure that an estimated 56 million participants in about 1 million private pension plans receive earned benefits. The assets of these plans were estimated at $375 billion as of 1979.

ERISA neither requires businesses to establish pension plans nor prohibits businesses from terminating them. However, with few exceptions, both continuing and new private plans must comply with the act's provisions. To protect employees' interests, ERISA established comprehensive minimum standards and requirements that specify:

--How employees become eligible to participate in pension plans (participation standards).

--How employees earn a nonforfeitable right to pension benefits (vesting standards).

--How the plans are to be funded (funding provisions).

--How the plans are to be operated in the best interests of plan participants (fiduciary standards).

--To what extent plan information is to be reported and disclosed to the Federal Government and plan participants (reporting and disclosure requirements).

The act also established an insurance program for guaranteeing the payment of certain benefits to participants of defined benefit plans if a plan terminates without sufficient assets to provide vested benefits.

Responsibilities for carrying out ERISA's provisions are assigned to the Department of Labor, IRS, and PBGC. Labor is primarily responsible for issuing regulations on and enforcing ERISA's fiduciary provisions and making sure plan information is reported and disclosed to plan participants. IRS issues regulations on and enforces the act's participation, vesting, and funding provisions. PBGC administers the defined benefit plan termination insurance programs.

This report discusses only the responsibilities of IRS and PBGC involving the administration of pension plan terminations and pension distributions for tax purposes.

PROCESSING TERMINATING PENSION PLANS

IRS and PBGC have separate responsibilities for processing terminating pension plans that derive from their differing legislative mandates; IRS assures ERISA and Internal Revenue Code compliance for all pension plans and PBGC provides insurance coverage to that portion of the plans that have defined benefits. Defined benefit plans are generally larger plans comprising 15 percent of all pension plans but serving about 70 percent of all pension plan participants. To the extent that both IRS and PBGC cover defined benefit plan terminations, plan information of mutual benefit is exchanged.

Internal Revenue Service

Under the Internal Revenue Code, sponsors of terminating pension plans may (1) determine without Government review whether their termination actions conform to participant protection requirements of ERISA and the Code or (2) voluntarily request an IRS review to determine whether their actions conform. When a plan is determined to conform with the requirements of ERISA and the Code, the plan and its participants can receive favorable tax treatment. Examinations of pension plan conformance may be initiated by IRS at its discretion and can include reviews of both plan design and operations to assure that the plans are written and operate in accordance with ERISA requirements. However, IRS gives high priority to processing sponsor requests for an IRS review and determination.

Plan administrators can request an IRS review and determination of conformance for new, amended, and terminated plans. Although IRS determinations can be revoked or modified by IRS, they help assure sponsors and plan participants that their plans meet ERISA requirements and are qualified for favorable tax treatment.

Upon termination of a pension plan, a plan administrator requesting an IRS review may submit IRS Form 5310, "Application for Determination Upon Termination." (See app. I, p. 38.) During the 5 years ended September 30, 1980, IRS received about 60,000 such requests.

When pension plans terminate or employees terminate participation, IRS is obligated to assure that one-time lump-sum pension payouts to plan participants are properly reported for tax purposes by employers and by terminated recipients. IRS uses income reporting forms, which employers were required to give to IRS and plan participants, as notification that a pension payout has occurred. IRS uses computer matching procedures to compare these reports with individual income tax returns to determine if payouts have been properly reported for tax purposes.

Within IRS headquarters, the Assistant Commissioner of Compliance has overall responsibility for enforcing individual taxpayer compliance, and the Assistant Commissioner of Employer Plans and Exempt Organizations has overall responsibility for enforcing ERISA's minimum standards. The IRS Employee Plans Division provides guidance and direction to, and evaluates the activities of, the staff assigned to ERISA activities in the 7 regional and 17 key district offices nationwide. 1/ The Assistant Regional Commissioner of Examinations, under the jurisdiction of the Regional Commissioner, is responsible for planning, coordinating, and evaluating the employee plans' activities of IRS district offices.

<u>Pension Benefit Guaranty Corporation</u>

Employers terminating defined benefit plans are required to (1) notify PBGC at least 10 days before the date they propose to terminate their plans and (2) report whether their assets are sufficient to pay benefits promised to participants. PBGC's Office of Program Operations, headquartered in Washington, D.C., reviews the plans to determine sufficiency. If plan assets are sufficient, the plan administrator or trustee distributes them to participants through such methods as lump-sum payments or purchases of annuities for participants. If a plan's assets are insufficient, PBGC may take over the plan's existing assets, as trustee of the plan. PBGC

1/Although IRS has 58 district offices, employee plan activities are primarily carried out by 17 offices which are referred to as "key" district offices.

is to make up the insufficiency either from the sponsor of the terminated plan, if possible, or from premium collections from ongoing plans. PBGC records show that about 89,000 defined benefit plans with about 33 million participants are covered by its termination insurance programs and are paying premiums which can be used to cover insufficiencies of terminated plans. During the 6 years since enactment of ERISA in September 1974, PBGC has received 32,534 notices of intent to terminate defined benefit plans.

OBJECTIVES, SCOPE, AND METHODOLOGY

Our review was undertaken to assess the effectiveness of the practices and procedures of (1) IRS and PBGC for ensuring pension plan terminations are reported, (2) IRS for processing plan terminations, and (3) IRS for ensuring compliance with income tax requirements by individuals receiving pension payouts. PBGC and IRS were implementing changes to improve the timeliness of termination processing during our review. We excluded these efforts from the scope of our work, and we focused on the PBGC and IRS methods of identifying nonreporting pension plans and the quality of IRS compliance reviews of terminations. The quality of PBGC's review of plan asset sufficiency was not within the scope of requested work on this assignment. Limitations on our access to pension plan financial and operating data supporting what plans report to the Federal Government precluded verification of the reliability of the information being submitted by plan administrators.

In assessing the adequacy of IRS' and PBGC's efforts to ensure terminating pension plans are reported, we (1) reviewed the agencies' procedures relating to terminating plans identification and (2) performed computer analysis of IRS' and PBGC's automated 1977 pension plan data. The reliability of the terminating plan information used to make the computerized data comparisons was the subject of agencies' evaluations while our review was in progress. (See ch. 3 for a discussion of the limitations in the accuracy of computer data found by the agencies and subsequent improvements made.)

To assess the quality of IRS efforts to ensure terminating plans meet ERISA and the Internal Revenue Code requirements, we reviewed IRS' files on 300 determined terminated plans completed by IRS' district offices in Philadelphia, San Francisco, and St. Louis during January through March 1979. The IRS district offices were selected to (1) provide coverage of IRS regional offices having voluminous plan terminations for review and (2) make effective use of our resources. We selected the first 100 termination cases completed by each of the three IRS district offices during 1979. Although not projectible nationally, the processing issues identified were mainly common to each IRS district office selected.

To assess the quality of IRS' efforts for assuring that pension plan participants meet tax requirements when they receive lump-sum pension payouts, we reviewed IRS' procedures for (1) identifying the reporting of pension payouts and (2) matching by computer employer and participant reporting of pension payouts for tax purposes. We also reviewed related IRS studies on tax reporting experience with pension payouts. Complete data on IRS tax recovery experience on pension payouts were not available as of May 1981 for tax years after 1976.

CHAPTER 2

IRS SHOULD MAKE MORE COMPLETE REVIEWS OF PENSION PLAN TERMINATIONS

IRS reviews of private pension plan termination actions have not assured that the terminating plans conformed to ERISA and the Internal Revenue Code requirements, which are designed to protect participants' benefits. Guidelines for IRS reviews of plan terminations have been fragmented and often they are unclear on the purpose of or objective to be sought by IRS reviewing officials. As a result, terminating plans have been reviewed and favorable determinations of conformance rendered by IRS without:

--Information necessary to determine whether plans are qualified.

--The plans' having met requirements established under ERISA and the Internal Revenue Code to protect participant benefits.

--Resolving reported discrepancies or questionable plan operations.

If a terminating plan has previously received a favorable IRS determination, IRS' review focuses on plan operations with primary emphasis on the equity of distribution of assets among plan participants. If an IRS determination has not been previously requested IRS generally performs a more comprehensive review of the original plan document and/or related information to determine if the plan as written is tax qualified.

We examined IRS determinations for 300 termination applications which were completed by three IRS district offices from January to March 1979. We assessed the adequacy of the information on which determinations were based and the approach used by IRS in making its review. All of the terminated plans we reviewed received favorable determination letters from IRS indicating that the plans conformed with the requirements of ERISA and the Internal Revenue Code.

ESSENTIAL DATA MISSING FROM TERMINATION APPLICATIONS

Of the 300 plans in our review, 74 were missing information necessary for IRS reviewers to make a positive determination of qualification. Although there was a followup made by IRS, much of the information needed on these cases was not obtained. The following table illustrates some of these omissions:

Omissions from pension plan applications for IRS determination	Number of plans omitting
Employees' ages at termination	11
Compensation information	10
Pension forfeiture amounts to participants	8
Years of employee participation	6
Distribution of plan benefits	5

A termination application contains both general identification information as well as data on the operating and financial characteristics of the plan. (See app. I.) Essential characteristics include such items as the reason for plan termination, plan participant data (such as the number of active and retired employees), data on trust fund assets and liabilities, total participant pension benefits forfeited, 1/ and the amounts distributable to the 25 highest paid participants.

One of the terminating plans in our review was sponsored by a medical firm that terminated its profit sharing plan after about 10 years of operation. Three participants--two owners and an employee--were in the plan when it terminated, and another participant left a few years earlier after at least 2 years of participation. The termination application to IRS neither reflected any forfeitures nor reflected the number of years each remaining participant had been in the plan. It could be determined from the application, however, that the other three participants were in the plan for at least 6 years.

IRS files did not contain a copy of the pension plan, thus precluding determination of the vesting rights of the terminated employee. The assets to be distributed amounted to $105,520 with the two owner-employees receiving $52,299 each and the nonowner employee receiving $922. An IRS official told us that additional information should have been obtained before granting a favorable determination. He stated that, from the data available, it cannot be determined whether all participants of the plan had been treated equitably.

1/When an employee ceases participation in an active plan, the nonvested portion of the individual's benefits are forfeited. Forfeiting occurs because individuals did not have enough years of service under the plan to be fully vested. For example, a plan provides 10-percent vesting per year with 100-percent vesting after 10 years of service. If a participant worked 5 years for the plan sponsor and then terminated employment, he or she would be 50-percent vested in his or her earned benefits so that he or she would receive 50 percent and forfeit 50 percent.

Another terminating plan was sponsored by a fast food employer who failed to show the amount of each of the three participants' total compensation during the approximately 7 years the plan was in existence. Necessary compensation information was not obtained to judge whether participants' proposed benefits were correct based on their ages and years of service. An IRS district official told us that there was insufficient information to determine whether the distribution of $60,162 in plan assets was made correctly. The three participants were plan members since the establishment of the plan. One owner-employee was 65 years old at the time of the plan termination and was to receive $33,283 in pension benefits. The other owner-employee was 60 years old and was to receive $19,550 in benefits. The nonowner-employee was 64 years old and was to receive $7,329. The IRS district official stated that the plan administrator should have been required to complete the missing information before a favorable determination was granted to help ensure that the distributions of assets had been equitable.

TERMINATING PLANS NOT IN COMPLIANCE WITH ERISA REQUIREMENTS

In our review of the 300 terminating pension plans, we found that IRS had not established as part of the determination process whether 56 plans were originally written or subsequently amended to conform with ERISA requirements. Plans operating under ERISA were required to come into compliance with requirements of the act no later than December 31, 1976. IRS files did not contain plan documents or other plan design information for 27 of the 56 plans, thus precluding IRS from ascertaining whether the plans complied with ERISA. For the other 29 plans, pension plan documents were available and we reviewed them for compliance with certain ERISA

participation, vesting, and joint and survivor provisions. 1/ As shown below, 23 of these plans did not meet one or more of the ERISA requirements.

ERISA provisions	Requirements not met by plans
Participation	1
Vesting	11
Joint and survivor	14
Total	a/26

a/Twenty plans did not meet one of the ERISA provisions, and three plans did not meet two ERISA provisions.

One plan, sponsored by a veterinarian, required full-time company employees to accumulate 1,560 hours of employment a year before receiving credit for 1 year of service. Under ERISA participation requirements, pension plans must provide credit for 1 year of participation to each employee working 1,000 hours or more within a 12-month period. This participation minimum was established to ensure plan coverage for employees, such as seasonal workers or part-time employees that might not accumulate enough working hours for participation in the plan based on a full working year.

Eleven other plans did not meet ERISA vesting provisions because they require more than 1 year of service (generally 3 years) for participation, but did not provide 100-percent vesting upon participation. ERISA provides that employees generally must be allowed to participate in a plan after they are 25 years old and have completed 1 year of service. However, a plan may provide for participation after age 25 and 3 years of service if employees are given a nonforfeitable vested right to 100 percent of accrued benefits when they begin to participate.

Fourteen of the plans did not meet ERISA requirements for joint and survivor provisions. Although they offered lifetime pension annuities, joint and survivor provisions either were not offered or had to be selected in writing instead of being automatic unless rejected in writing as required by ERISA.

1/ERISA requires that most retirement plans which provide for participants to take retirement benefits in the form of an annuity must also provide for a qualified joint and survivor annuity. A qualified joint and survivor annuity is automatic unless the employee rejects it in writing.

DISCREPANCIES AND QUESTIONABLE PLAN OPERATIONS NOT RESOLVED

Pension plan applications for an IRS determination upon termination included discrepancies and described questionable plan operations that were not effectively pursued or resolved by IRS. Guidance provided IRS reviewers was fragmented among training courses, manuals, regulations, revenue rulings, and other instructions. Within these guidelines, reviewers have been afforded substantial latitude concerning when to question data furnished by pension plan administrators. We found, for the 300 termination cases we examined, that IRS reviews had been completed without adequately addressing:

--Inconsistent information on termination dates reported by pension plan administrators on IRS forms.

--Key indicators on IRS forms of potentially incorrect asset distributions.

--Discrepancies in reported plan assets or eligible plan participants.

--Relatively high rates of participant departures and benefit forfeitures.

IRS did not further pursue these issues, through inquiries with plan administrators and requests for substantiating documentation. Thus, IRS reviews did not assure that plan participants were treated equitably as required by ERISA or the Internal Revenue Code.

Inconsistent reporting of termination dates was not questioned

Fifty of the pension plans in our review had filed inconsistent information with IRS on termination dates. The termination determination applications identified termination dates having been established ranging from 6 months to 4-1/2 years before the applications' being submitted to IRS. Our review of previously filed annual reports covering the plans' proposed termination dates showed discrepancies indicating that the plans had not been terminated at the dates indicated. IRS reviews did not question these discrepancies, and data were not available for us to show the actual impact on participants' benefits.

The effective date of termination is important because it can impact on the amount of benefits a participant receives. Upon the termination of a pension plan, participants' accrued benefits become nonforfeitable. If the termination date is later than established, plan participants can lose pension benefits because:

--Required contributions are not being made.

--Timely notice is not given which would allow participants to establish individual retirement arrangements since they were not covered by a private pension plan.

--Participants not fully vested that terminate employment after the proposed plan termination date would receive only partial benefits instead of full benefits as required when a plan is terminated.

IRS provided quidelines for verifying termination dates established by plan sponsors by reviewing, where deemed necessary, written notification of termination or records showing the date of discontinuance of pension contributions. IRS reviewers did not request additional data or verify the dates of termination even though many plan sponsors requested an IRS termination determination several years after the dates they proposed to terminate their plans.

Inadequate review of pension assets distributed to highly compensated employees

ERISA specifies that a pension plan must operate for the exclusive benefit of plan participants and it must not discriminate in favor of officers, stockholders, or highly compensated employees--referred to by IRS as the "prohibited group." To help identify whether terminating pension plans have met such requirements, IRS requires the reporting of the proposed distribution of assets to the 25 highest salaried participants and the accumulated salary of these individuals over the last 10 years. IRS reviewers had been given little guidance as to when to question the data furnished. As a result, we found IRS reviews seldom questioned distributions which appeared inequitable or incorrect.

We questioned IRS officials in Washington, D.C., and in the district offices of Philadelphia, San Francisco, and St. Louis as to what criteria reviewers should apply to determine whether discrimination in the distribution of plan assets may exist. Generally, the officials indicated as a guideline that the IRS reviewers should determine whether the ratio of benefits to compensation is higher for the prohibited group members.

We identified 56 terminating plans that reported proposed distributions of assets that were questionable. Only six of these plan distributions had been questioned by IRS and were subsequently resolved. We discussed the other plans with responsible IRS reviewing officials who indicated that the distributions were questionable and favorable determination letters should not have been issued without resolving these questions.

In addition, our review of terminating plans disclosed that 13 defined benefit plans terminating before completing 10 years of operation had not complied with the early termination restrictions placed by IRS on the amount of benefits that could be distributed to the highest paid employees in the plans. Upon termination of a defined benefit plan within 10 years of operation IRS can limit the distribution of benefits derived by the highest paid 25 participants whose anticipated annual pension exceeds $1,500. The limitation is from employer contributions to the greater of $20,000 or 20 percent of the employees first $50,000 of annual compensation multipled by the number of years the plan was operated before termination.

Of the 13 plans, 4 were questioned and resolved by IRS and 9 were not. One of the plans questioned by IRS was sponsored by a bank and was terminated after 4 years of operation. There were 17 plan participants--2 owners and 15 employees--at the time of termination, but only 10 were to share in the pension assets of $94,464. IRS reviewed the termination application, obtained additional information from the plan sponsor, and determined that the two owners were to receive $23,642 in excess benefits because of the early termination restrictions. Based on IRS' determination, the plan sponsor agreed to redistribute the excess among the 15 employees, including 7 participants originally scheduled to receive nothing. Benefit increases to these participants ranged from $118 to $4,165.

Unresolved discrepancies in reported pension assets and eligible participants

Data reported in determination applications to IRS by 37 terminating plans in our review included unresolved differences in reported pension assets to be distributed and/or in the number of plan participants sharing in the distributions. IRS lacked written criteria and procedures IRS reviewers were to follow when differences in data reported by plan administrators were received. As a result, favorable determinations were rendered without reported discrepancies being resolved.

Pension plan termination applications include a balance sheet for disclosure of the trust fund assets, liabilities, and the net difference referred to as asset reserves. (See app. I, item 21.) The form also includes financial data describing the amount of assets to be distributed among specific categories of eligible participants. (See app. I, item 17.) IRS headquarters officials stated that reported value of asset reserves of the plan should ordinarily agree with the total reported distribution of assets among certain participants. IRS district office officials stated that differences could result. However, all IRS officials agreed that any difference should be identified and resolved before rendering a favorable determination.

One of the cases reviewed was an automobile sales company which terminated its profit sharing plan after about 10 years, reporting asset reserves of $143,125 to IRS at the time of termination. Distributable benefits, however, were reported as $69,362. The termination determination was approved without questioning this difference. An IRS district office official stated that the plan file should have contained comments on the discrepancy and that the reviewer should, to the extent possible, have resolved the discrepancy.

The termination application also contains information on eligible participants in three places. (See app. I, items 16 and 17 and schedule A.) Reporting is by (1) total number of participants by various categories of eligibility, such as retirees and active participants, (2) turnover in participation with total participants for the year of termination, and (3) individuals for the purposes of benefit distributions. Total participants reported for these purposes should generally be equal for plans with 25 or fewer participants. One of the plans was sponsored by a lumber company that reported 14 participants in the eligibility category list, 10 participants by name as receiving a portion of the distribution, and 11 participants at the time of termination in the turnover schedule. An IRS official told us that the issuance of a favorable determination letter should not have been approved without resolving the discrepancy.

Significant participant turnover and benefit forfeitures were not adequately resolved

IRS had not provided adequate guidance for reviews of terminating plans to assure that the rights of participants leaving the employment of the plan sponsor near plan termination were protected. When a plan participant leaves the plan, the nonvested portion of his or her pension funds are forfeited. In defined contribution plans, except money purchase plans, 1/ the forfeited amount is generally allocated to the remaining participants based on a formula prescribed in the plan. In defined benefit and money purchase plans, the forfeited amounts are used to offset the employer's contribution to the plan. The more restrictive the plans' requirements are for employees to earn vested benefits, the greater the likelihood of participants forfeiting benefits due to either voluntary or involuntary termination of their employment.

1/A money purchase plan is one in which the employer's contributions are determined for, and allocated with respect to specific individuals, usually as a percentage of compensation.

High participant turnover, accompanied by substantial forfeitures can be an indication of (1) an earlier but unreported termination, 1/ (2) an effort to avoid vesting requirements by planned severance of employees, or (3) a plan that operated in a discriminatory manner resulting in substantial contributions being forfeited and reallocated to the prohibited group members. Such actions if identified would be inconsistent with the provisions of section 401(a)(4) of the Internal Revenue Code as amended by ERISA precluding discrimination in pension plan administration. IRS termination applications require plan administrators to provide participant turnover information for all pension plans and forfeiture data for most defined contribution plans. IRS has generally advised its reviewers to be concerned with high participant turnover and forfeiture of benefits, but has not provided adequate criteria to identify cases that should be pursued and when and what type of additional information should be requested from plan sponsors. As a result, the handling of such issues for the termination cases reviewed was not consistent.

We asked IRS management in Washington, D.C., and the district offices of Philadelphia, San Francisco, and St. Louis for their views on when the issues of turnover and forfeiture of benefits merit IRS attention and found that there was not a general concensus. All officials believed latitude should be afforded reviewers on when to question turnover and forfeitures. Some officials believed that a specific percentage rate could not be used to "flag" plans of concern. The San Francisco district management, however, indicated that, as a general rule, a 20-percent or more turnover rate should raise some concern. IRS' St. Louis district and headquarters management officials told us that reviewers should be concerned or should question turnover information if it appears (1) that the information conflicts with other information reported, such as high forfeitures and low turnover, (2) that employees may have been laid off or fired in contemplation of plan termination, (3) contributions ceased before the year of plan termination, or (4) there are "significant" decreases in plan participants. Thirty-one specialists that process termination applications at the three district offices visited told us that, in the absence of specific IRS guidance, they pursued high turnover and forfeitures using primarily their judgment. Some used as a rule of thumb, a specific percentage of turnover or forfeiture to question cases while others did not.

We reviewed the reported forfeiture information over the life of the plans for the 142 profit sharing plans in our review.

1/When a plan experiences a "substantial" decrease in plan participants during the year, IRS may rule the plan as partially terminated and terminated participants are to receive their full benefits regardless of whether or not they were 100-percent vested.

Of these plans, 79 (or 56 percent) reported forfeitures that totaled $1,005,477 ranging from $109 to $96,655. Ten of the plans had forfeitures greater than 25 percent of contributions; IRS reviewers questioned forfeiture allocations for five of the plans. However, even for the plans questioned, the issues were not adequately resolved.

One of the five plans questioned by IRS was a management consulting firm which terminated its profit sharing plan in 1978 after 9-1/2 years of operation because of dissolution of the company. At the time of termination, $86,995 in total forfeitures were reported or about 31 percent of total contributions. The plan's vesting schedule was amended effective January 1975 based on a favorable IRS determination to provide for full and immediate vesting upon participation. 1/ There were no minimum age and service requirements for plan participation. The IRS plan file did not show what the vesting requirements were before 1975. However, in 1974, before the adoption of full and immediate vesting upon participation, 26 of 33 participants left and in 1973, 22 of 52 participants left. The plan file did not show the amounts that 22 terminated participants forfeited in pension benefits for 1973. For 1974 data were available that showed 23 participants forfeited $66,997. The application of IRS for a determination upon amendment of the plan in 1975 showed the allocation of $60,875 of the $66,997 forfeited.

The amounts the participants forfeited in pension benefits ranged from $1 to $15,116. Three of the participants remaining with the plan were prohibited group members and received $49,291 (or 81 percent) of the $60,875 in forfeitures. One of these individuals was the owner of the company and the other two were company officers. One officer was hired in 1974, the same year the plan experienced substantial forfeitures. This individual received $30,321 in pension benefits of which $21,192 was forfeited benefits of other participants. This individual was only in the plan for 1 year then terminated employment in 1975. The IRS reviewer accepted the plan sponsor's statements that participants had left largely on a voluntary basis, and there was nothing in the plan file indicating an attempt to verify this information with departing participants who forfeited benefits.

Another example was an electrical repair business that terminated its profit sharing plan in 1977 after less than 3 years of operation. The plan sponsor reported total forfeitures of $7,264

1/ Full and immediate vesting upon participation under ERISA provides pension plan participants the nonforfeitable right to receive all accrued pension benefits when discontinuing employment, at retirement or at the time of plan termination after participation in the plan for no more than 3 years.

or about 57 percent of total contributions. The plan's vesting schedule provided no vesting until 10 years of service was completed after which participants became 100-percent vested. The plan had nine participants in its first year of operation with one individual leaving during that year. Four participants left the next year, and two participants left a year later, leaving only two participants, the owner and his son. The two remaining participants divided the trust fund assets of $12,835 which included the forfeitures of $7,264.

The IRS reviewer questioned the plan administrator about turnover and was told that the employees had been unhappy and left voluntarily. This explanation was accepted without attempting to verify the voluntary turnover. An IRS district official stated that a favorable determination letter should not have been issued without further inquiry, especially with the facts available--high turnover, high forfeitures, slow vesting, and only prohibited group members benefiting.

AGENCY ACTIONS AND OUR CONCLUSIONS

During our review, we discussed these problems and the lack of specific written guidelines for IRS termination reviews with IRS headquarters officials. Later, IRS developed a training course that covered termination reviews, and it developed new procedures and a detailed termination worksheet for identifying plan problems. The issues to be pursued include whether (1) terminating plans had been amended to comply with ERISA, (2) plans had actually terminated at the dates proposed, (3) discrepancies existed in plan assets and/or participants to receive benefits, (4) there was a high turnover of active participants and a high percentage of benefits forfeited, and (5) distributions to the higher paid participants were discriminatory under ERISA.

Implementation of the training course and new procedures is a positive step in improving IRS termination determination reviews. The new procedures bring together, in one source, termination review guidelines that should help to alleviate many of the deficiencies we identified as IRS reviewers gain experience with the procedures.

However, the procedures generally do not identify what reviewers should do when information provided by pension plans requesting an IRS determination is incomplete or inconsistent and what additional supporting documentation to obtain when questionable actions of plan sponsors are identified. In addition, the procedures do not establish criteria as to when participant turnover is significant enough to warrant questioning. Although IRS reviewers are

instructed to question and resolve these issues, without more specific guidance termination applications may continue to be processed inconsistently and without resolving questions concerning the terminations' qualifications.

RECOMMENDATIONS TO THE COMMISSIONER OF INTERNAL REVENUE

We recommend that the Commissioner:

--Establish quality control procedures to ensure that termination applications approved contain all necessary data for making such determinations.

--Establish a level of turnover for reviewers to use in deciding whether to question participant departures before plan termination.

--Identify documentation for reviewers to obtain when questioning possible discriminatory vesting, participant forfeitures, and questionable benefit distributions.

AGENCY COMMENTS

IRS officials told us that they agreed with our recommendations. In addition to the actions mentioned in this chapter, IRS is developing a Terminations Handbook which will serve as a single source document for use by IRS reviewers when processing plan terminations.

The Handbook will identify what the IRS reviewer should do when information provided by pension plans requesting an IRS determination is incomplete or inconsistent and what additional supporting documentation should be obtained when questionable actions of plan sponsors are identified. Procedures to be in the Handbook include:

--When a examination should be initiated based upon the review of the determination application.

--Establishment of a meaningful level of turnover above which IRS reviewers must question participant departures before plan termination.

--Development of a procedure to secure additional information from third-party contacts, including terminated participants, to verify information submitted with the termination application.

--Reconciliation of discrepancies between plan assets and participants' distributions.

--Identification of discriminatory distributions.

Also, effective January 1, 1982, all termination cases processed by IRS reviewers are to be given a second level of review by IRS' technical staff, and for fiscal year 1982, field workplans will require increased emphasis on the examination of terminated plans to assure compliance with all qualification requirements, especially those relating to employee benefits.

CHAPTER 3

BETTER GOVERNMENT PROCEDURES NEEDED TO IDENTIFY UNREPORTED PLAN TERMINATIONS FOR REVIEW

The IRS and PBGC efforts to identify unreported plan terminations have not been effective. Thousands of pension plans were terminated since the enactment of ERISA in 1974 without requesting an IRS review or, in some cases, without notifying PBGC. Thus, at the time of termination there is no assurance that, for many plans, the participants are adequately protected as required by ERISA and the Internal Revenue Code.

The process used by IRS that permits sponsors of terminating pension plans to either (1) self-determine conformance with ERISA and the Internal Revenue Code participant protection requirements as the basis for qualifying for preferential tax treatment or (2) request that IRS review and determine conformance of their actions has not been effective. Our analysis of the 1977 annual report filings showed that, for about two-thirds of reported terminations, plan sponsors were not requesting IRS reviews at the time of termination. Therefore, IRS' adoption of our recommendations as stated in chapter 2 to improve its reviews of terminating private pension plans, will not, of itself, assure that participants of terminating plans are adequately protected since most sponsors of terminating plans do not request IRS reviews.

IRS has been concerned that plans that have not voluntarily requested a review by IRS--at some point during the plans' operating life or at termination--are more likely not to meet ERISA and the Internal Revenue Code requirements. As a result, IRS has increased examinations (audits) of these plans in an effort to mitigate potential problems with unreported plan noncompliance. However, the length of time required for IRS to identify the occurrence of a plan termination means that these examinations ordinarily cannot be made until years after the plans terminate and assets are distributed. The examinations do not provide plan participants with the advantages and benefit protection that an IRS review before termination would provide.

Our analysis of the 1977 annual report filings also showed that, for over one-third of reported terminations that indicated coverage or possible coverage by PBGC's termination insurance program, there was no matching automated record of filing with PBGC.

Participants' benefits from terminating plans could be better protected and unreported pension plan terminations could be more effectively identified if IRS reviews of pension plan terminations were made mandatory under the Internal Revenue Code

and PBGC and IRS effectively utilize automated records to identify unreported pension plan terminations.

MANDATORY DETERMINATIONS BY IRS WOULD IMPROVE TERMINATION REPORTING AND PROTECTION OF PARTICIPANTS' BENEFITS

IRS reviews of terminating pension plans are not mandatory, and many administrators have not requested IRS reviews when they terminate their plans or have waited long periods of time, even years, after terminating their plans before requesting an IRS determination. Delays or inaction reduce the opportunity for timely identification and correction of plan problems to help assure participants' benefits are protected. Timing is critical to assure participant and Government involvement in decisions on the distribution of assets.

Many plan administrators have requested at some point during their pension plan's operating life that IRS review plan actions and determine whether they conform to the requirements of ERISA and the Internal Revenue Code. IRS officials, however, told us they are concerned with plans that do not voluntarily request IRS reviews because they believe there is a greater chance of them not meeting ERISA and the Code requirements. IRS has increased examinations of these plans in an effort to mitigate potential problems with unreported plan noncompliance. However, the length of time required to identify the occurrence of a plan termination means that these examinations cannot ordinarily be made until several years after the plans are terminated, and thus, they do not provide plan participants with the advantages and benefit protection that an IRS review before termination would provide. Timely recognition and review of terminations by IRS can provide greater assurance that:

--Plans meet ERISA and the Code participant protection requirements and are tax qualified.

--Participant benefits will be guaranteed by PBGC under ERISA's termination insurance programs.

--Plan participants have a vehicle to protect their own interests through direct involvement in the sponsors' termination actions.

--Less future Government effort will be spent in making detailed examinations of plans years after termination.

The determination by IRS of terminating pension plan conformance with ERISA and the Internal Revenue Code requirements should be made mandatory by amending section 401(a) of the Code which established trust requirements for pension plans created or organized

in the United States to qualify for preferential tax treatment. To be tax qualified under this section of the Code a pension plan must be operating in conformance with a series of specific legislative requirements intended to protect participants benefits. Amending section 401(a) of the Code to require plan administrators to obtain an IRS review and determination of termination action conformance as a requisite to asset distribution at termination would provide IRS with authority to withhold preferential tax treatment until plans conform to ERISA and the Code participant protection requirements.

Importance of plan determinations at termination

The adequacy of plan determinations of conformance at termination is critical. If not made effectively, the plan may go out of existence without equitably distributing plan assets among qualified participants. If made too late, it may be difficult to locate qualifying participants or to reconstruct plan actions at termination. Because plan sponsors may self-determine conformance with ERISA and the Internal Revenue Code participant protection requirements when they initiate, amend, or terminate their plans, it is possible for a plan to operate for several years and dissolve without any outside scrutiny of conformance with participant protection requirements.

For new plans requesting an IRS determination, IRS reviews plan design documents to ensure that they are written to meet ERISA and the Internal Revenue Code participant protection requirements. Since the plan design provides the framework for plan operations, an effective determination is important to help ensure that plans operate properly from their inception. For plans with a prior IRS determination and requesting an IRS review of amendments, IRS review work focuses on the specific changes and related information rather than a comprehensive review of the plan. For termination determination requests, IRS obtains and reviews select information on plan operation at termination, focusing on the fairness of asset distribution between participants of the plan. Where a terminating plan has not obtained an initial IRS determination of conformance, IRS may request and review the original plan design document or related documents at termination.

A determination of conformance by IRS at termination helps assure the benefits promised by terminated defined benefit plans will be covered by PBGC's benefit guaranty programs, and provides employees the opportunity to comment on and participate in IRS decisions leading to a determination. Plan administrators are required to notify interested parties when requests for an IRS determination at termination are made, and IRS is required to consider interested party comments in making the determination. This puts working plan participants on notice that they may have to start

providing for their own retirement benefits and allows them to take advantage of special tax treatment on a timely basis if they decide to contribute to an individual retirement arrangement. 1/

Termination determination requests have not bee. timely

Although IRS records show that over 90 percent of the more than 385,000 corporate and large Keogh pension plans 2/ in existence during 1977 have requested IRS determinations upon plan inception or amendment since ERISA's enactment, many terminating plans had not requested a determination until several years after plans were terminated.

We obtained IRS automated records of pension plan annual reports for 1977 to identify the level of IRS determinations accomplished on terminated plans as of August 1979. Of 15,254 plans that had been terminated:

--10,274 with an estimated 391,809 participants had been terminated from 8 to 19 months without applying for an IRS termination determination.

--457 of the plans not determined by IRS with an estimated 8,029 participants had not applied for any type of IRS determination since ERISA's enactment.

--5,118 of the plans not determined by IRS with an estimated 182,829 participants had distributed assets an average of 13 months before August 1979.

In addition, our review of 300 termination determination cases closed by three IRS district offices during the 3-month period (Jan. through Mar. 1979), showed that 81 (27 percent) applied for the determination from 1 to more than 3 years after

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1/The Internal Revenue Code provides that contributions of certain amounts by individuals not covered by a qualified pension plan to their own individual retirement arrangements are tax deductible, and the contributions and their investment earnings are not taxed until received from the arrangement.

2/Excludes Keogh pension plans with fewer than 100 participants. Keogh pension plans are sponsored by self-employed individuals and their employees. There are about 600,000 of these plans with fewer than 100 participants. According to an IRS official, most of these smaller Keogh plans were established by adopting prototype plans that had already been approved by the IRS national office, and therefore, they do not require individual determinations.

the date set by plan administrators for termination. The following table shows the lapsed time from the date set by plan administrators for termination until request for IRS termination determinations were made for the 300 plans.

Elapsed time	Plans: Number	Plans: Percent of total
Less than 1 year	219	73
1 to 2 years	52	17
2 to 3 years	19	6
More than 3 years	10	3
Total	300	a/99

a/Does not total 100 percent due to rounding.

IRS officials have indicated that the time involved in identifying plans that have not been determined by IRS, can hinder IRS' effectiveness in taking corrective actions needed to protect participants' benefits when plans are found not to be in compliance. This is of particular concern for terminated plans where the company may have gone out of business and/or pension assets were distributed.

Examinations not as effective as timely determinations

During fiscal year 1982, IRS plans to select terminated plans for examination that have not requested an IRS determination using computerized information obtained through its receipt and processing of ERISA annual reports. The effectiveness of this automated program for the timely selection of such plans for examination has inherent limitations. Plan annual report information may not be available for targeting plan examinations for up to 2 years after plans are terminated.

The time lost in identifying and examining terminated plans not previously determined by IRS materially detracts from IRS' effectiveness in ensuring the protection of participants' benefits under ERISA because of (1) the greater the likelihood that employees may have relocated, (2) plan records and personnel files become less accessible, and (3) assets have probably been disbursed. In addition, when a terminated plan not previously reviewed by IRS is examined and found in noncompliance:

--The sponsor and participants may be subject to retroactive taxes and interest on contributions to the plan.

--Investment earnings on assets of the plan's trust may be taxed as income to the plan.

--Plan participants' benefits may not be guaranteed by PBGC for the years the plans were not in compliance.

--Affected parties may not be afforded the opportunity of early involvement in the termination process to help protect their interest.

PENSION PLAN TERMINATIONS ARE NOT EFFECTIVELY IDENTIFIED

Agency studies and our analysis of agencies' computerized information and related program data indicate that thousands of pension plans have terminated since the enactment of ERISA without notifying PBGC as required by law or requesting an IRS review and determination. Because agency computer data were not always reliable, the exact number of unreported terminations cannot be precisely determined. The PBGC and IRS initiatives directed at obtaining more accurate and timely data on plan terminations have been met with limited success to date because of difficulties in developing reliable computer data bases for terminating plans and the reluctance to contact potential terminating pension plans to determine their status. Some of these efforts resulted in ineffectively using staff and available resources.

IRS and PBGC reporting requirements

Administrators of defined benefit plans covered by PBGC's termination insurance programs are required under ERISA to notify PBGC at least 10 days before the proposed date of termination. Plan administrators whose plans are covered by ERISA are required to identify terminations that have occurred during the current or any prior plan year on IRS annual information reports. The reports are to be filed within 7 months after the close of the reporting plan year and each year thereafter for terminating plans until assets have been distributed.

Reports of terminating defined benefit pension plans to PBGC include information on plan assets, guaranteed vested benefits, and eligible participants. Annual reports filed by pension plans with IRS include financial statements and schedules showing information on the current value of plan assets and liabilities; actuarial data; and details of financial transactions, participation, and plan modifications. IRS will use the data to identify plans that are not in conformance with ERISA and the Internal Revenue Code requirements.

Independent efforts to identify terminating plans are not effective

As of early 1977, PBGC identified record entries for 140,000 defined benefit plans from its premium payment history files, but its premium collection files for the most recent year of filings covered only 70,000 plans. To determine what caused this discrepancy, PBGC made a computer analysis of a sample of its premium payment history files. PBGC estimated that, of the 140,000 records of plans in the history files, 38,000 could represent duplicate filings, 26,000 could have ceased filing with PBGC for reasons, such as termination or compliance problems, and 22,000 could represent a potential coverage question for PBGC insurance. PBGC was not able to reconcile these differences and was reluctant to contact potential terminating plans identified because of the inaccuracy of its automated data.

Later, in September 1978, PBGC through contract began using a newspaper clipping service to identify companies undergoing financial difficulties possibly resulting in pension plan terminations. According to a PBGC official, this program was discontinued in early 1979 because it spent a great deal of staff time, and the number of unreported terminations discovered was small.

In September 1977, IRS initiated a special study to determine the status of plans for which IRS had no record indicating whether such plans had been revised to conform to the new requirements of ERISA. As part of the study, a questionnaire was furnished to 309,106 plans and IRS found that many plans had terminated without a determination. As of December 1979--more than 5 years after enacting ERISA and 2 years after the special program was started--42,711 plans either had not responded to the questionnaire or had stated they would file for a determination but had not yet done so. Of the other plans, IRS found that 93,324 were terminated. IRS' followup action on terminations was limited because most of them were reported as occurring before the enactment of ERISA.

IRS began a new program in January 1979 to identify all pension plans that may be delinquent in filing annual reports, including those for terminating plans. The program was stopped shortly after it was started due to erroneous data in IRS' automated files. IRS officials told us that they have improved the reliability of their automated data and plan to continue such efforts towards identifying delinquent reporting.

Efforts to identify terminating plans by comparing IRS and PBGC data

To identify possible inconsistencies in pension plan reporting of terminations to PBGC and IRS, we compared the most recent PBGC's automated termination reports with automated information available on plan annual reports filed with IRS. We identified 2,769 terminated defined benefit plans that reported to IRS in 1977 annual filing forms as being covered by PBGC's termination insurance program or uncertain as to their PBGC coverage. Our comparison of PBGC records indicates that 1,024 of the plans with an estimated 85,575 1/ participants had not reported terminations to PBGC. A portion of these unreported terminations could result from inaccuracies in basic identification data recorded in the agencies' automated data systems or a question of uncertainty of coverage under PBGC's insurance program.

In September 1980, PBGC attempted to identify unreported defined benefit plan terminations by matching data from 1978 annual pension plan reports filed with IRS against PBGC's automated records of reported terminations. The match included about 58 percent of the plans filing annual reports for 1978, and PBGC found 855 defined benefit plans indicating termination on IRS annual forms were not shown as filing with PBGC. Recognizing the unreliability of its automated information, PBGC selected 100 of the 855 plans and manually reviewed program records for filings. Based on the test, a PBGC official concluded that unreported terminations in 1978 could range from about 725 to 920. 2/

The PBGC official told us that, although progress was being made as of May 1981, PBGC had not followed up with potential terminating plans because of the time involved in assuring reliability of its data and the continuing concern with the impact of contacting numerous plan administrators without correct information on their reporting status. He noted that any unreported termination could have resulted in lost pension benefits to participants if the plan did not have sufficient assets to pay PBGC guaranteed benefits. Subsequently, PBGC mailed inquiries to 741 of the potential 855 plan terminees identified earlier and, as of September 1981, PBGC was assessing the responses received thus far.

1/Of the 1,024 plans, 197 did not report the number of plan participants, and we estimated their participants based on the average number of plan participants for plans that had reported.

2/PBGC's estimate was intended to reflect the maximum number of unreported terminations that could be identified if there were no exclusions from insurance coverage due to improper filings by plans or previous filings not identified properly during PBGC's computer match.

AGENCY ACTIONS AND OUR CONCLUSIONS

PBGC and IRS have acted to improve computer systems to identify nonreporters of terminated plans; however, these efforts have had limited success and a more coordinated effort is needed. A primary reason has been the unreliability of the automated data needed to identify nonreporters. PBGC, in cooperation with IRS, needs to improve and more effectively use the automated records of both agencies to identify unreported plan terminations for timely followup.

For IRS an effective automated reporting program, in itself, is not sufficient to identify nonreporters and protect participants' benefits. Plans can be terminated for several years before IRS identifies them as unreported and examines them. At this point, corrective actions may not be possible to protect participants' benefits if the sponsoring company has gone out of business and pension assets have been distributed.

IRS and PBGC are designing a process called "one-stop shopping" that would provide a single form for all terminating pension plans to report their actions to them. The process now targeted for completion in 1982 incorporates mandatory PBGC reporting requirements into the voluntary application form plan administrators use for requesting an IRS determination upon termination. (See app. II.) Implementation of the process could improve report processing for terminating plans and reduce future disparity in termination reporting to IRS and PBGC. However, plan administrators may elect, under the process, not to request an IRS review of ERISA participant protection requirements while applying to PBGC for permission to distribute assets. Without an IRS review of the actions of terminating pension plans, PBGC lacks assurance that the asset distributions it approves are made in conformance with ERISA participant protection requirements.

Revising the Internal Revenue Code to require pension plan sponsors to obtain an IRS determination of conformance with ERISA and the Code requirements would better protect participants' benefits and improve reporting of plan terminations. This could be accomplished by adding to section 401(a) of the Code a new paragraph (23):

> "A trust shall not constitute a qualified trust under this section unless the employer or administrator of the plan of which such trust is part requests from the Secretary within 90 days prior to the effective date of plan termination, a determination that such

terminating plan conforms to the requirements of the Internal Revenue Code." 1/

RECOMMENDATION TO THE CONGRESS

The Congress should enact legislation requiring plan sponsors to request an IRS determination for tax qualification of terminating pension plans before plan dissolution.

RECOMMENDATIONS TO THE EXECUTIVE DIRECTOR OF PBGC AND THE COMMISSIONER OF INTERNAL REVENUE

We recommend that the Executive Director, in cooperation with the Commissioner, use the automated records of both agencies to identify nonreporters of plan terminations. We also recommend that the Executive Director establish procedures for timely followup with potential nonreporters to ensure participants in terminated plans, entitled to retirement benefit insurance, are afforded the protection intended by the Congress under ERISA.

AGENCY COMMENTS

IRS and PBGC officials told us that they agreed with our recommendations. (See app. III on p. 42 and app. IV on p. 45.)

PBGC stated that a combination of (1) a computer matching program of the IRS annual report with PBGC records, (2) implementation of the IRS and PBGC "one-stop shopping" program, and (3) implementation of our recommendation for mandatory tax qualification determination filing for plan terminations will provide a significant measure of assurance that both agencies receive substantially complete reporting of plans upon termination. IRS indicated that it would be contacting PBGC to discuss the feasibility of mutual use of agency records to identify nonreporters.

IRS indicated that it was in general agreement with our recommendation that the Congress enact legislation requiring plan sponsors to request an IRS determination of tax qualification before plan dissolution. IRS indicated that it would require notice of termination 90 days before plan termination to consider any interested party comments generated as a result of the termination determination application. We modified our suggested legislative language on page 28 to accommodate this requirement.

IRS noted that our proposed language would not prevent the distribution of plan assets after a determination request is made, but before IRS completes it review. It also indicated that any legislation in this area should also reflect the needs of PBGC.

1/As a result of IRS' comments to our draft report, we revised the number of days from 60 to 90. (See app. IV, p. 52.)

It is our view that PBGC would be more certain of its actions when approving plan sponsors distribution of assets for defined benefit plans if a positive determination of plan conformance with ERISA and Internal Revenue Code participant protection requirements had been completed by IRS. With the enactment of our legislative proposal, reporting to IRS would be mandatory 90 days before plan termination. Reporting of plan asset data to PBGC is currently required under ERISA at least 10 days before plan termination, but asset distribution is not usually approved by PBGC until 90 or more days have elapsed after termination.

To accommodate PBGC's needs, the proposed "one-stop shopping" process could be modified to provide an option for plan sponsors to either (1) report asset sufficiency data used by PBGC if it were available 90 days in advance of termination when requesting an IRS determination of conformance with ERISA and Internal Revenue Code participant protection requirements or (2) report data needed by PBGC anytime within the next 80 days to conform with the 10-day advance reporting requirement in ERISA.

Although our legislative proposal, as IRS points out, does not specifically preclude the possibility that plan sponsors could distribute assets before an IRS determination is completed, we believe that there are conditions that will militate against this occurring. Distributions of assets of defined benefit plans would ordinarily be approved by PBGC after the completion of an IRS determination. Where PBGC completes its review before IRS', PBGC should withhold approval of such distributions until IRS renders its determination. Plan sponsors of defined benefit plans should be required by PBGC to conform to distributions of assets among participants approved by IRS as conforming with ERISA and Internal Revenue Code requirements. For defined contribution plans, which are not subject to the PBGC insurance program, but must meet the participant protection requirements of ERISA and the Code, the possible loss of tax qualification should be the deterrent to plan sponsors distributing plan assets before completion of an IRS determination.

CHAPTER 4

IMPROVED OVERSIGHT OF PENSION ASSET

DISBURSEMENTS COULD INCREASE TAX REVENUE

Many employees or their beneficiaries receive one-time lump-sum disbursements called pension payouts before their retirement years when private pension plans are terminated, employees terminate employment, employees die, or become disabled. To avoid preretirement pension payouts being lost due to taxes and to create an incentive for employees to save these distributions for their retirement years, ERISA permits reinvestment of this income within 60 days of receipt in another qualified pension plan.

During tax year 1976, about 2 million individuals that discontinued participation in pension plans or their beneficiaries received an estimated $6 billion 1/ in one-time lump-sum pension payouts for their entitled share of benefits. IRS procedures for identifying and processing tax compliance information on recipients of these payments have not been adequate. Pension payouts are taxable as ordinary income or capital gains when received unless the recipient reinvests the sum received in another qualifying pension plan. 2/

Although IRS made $4.3 million in tax assessments for unreported pension payouts in tax year 1976, IRS (1) did not process most of the payments reported on employer pension payout documents it received, (2) did not process pension payments reported by employers as capital gains, and (3) has not developed a method for assuring that employers are filing required forms (see app. II, p. 41). If reported pension payments are not processed by IRS in the year received, there is little likelihood the one-time payments will ever be reviewed. From the limited number of pension payouts that could be traced from IRS records, at least $9.6 million in tax revenues have been lost for unprocessed pension payouts in tax year 1976 alone. Also, IRS resources have been expended unnecessarily

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1/Our estimate was developed from the ordinary income portion of pension payouts reported by employers for tax year 1976 (latest year complete IRS pension payout data were available) and excludes that portion reported as capital gains. We confirmed the estimate with a responsible IRS official. Our methodology in deriving the estimate and other estimates in this chapter are based on proprietary IRS data.

2/For tax reporting purposes, the portion of pension payout representing participati in a pension plan before 1974 qualifies for capital gain treatment whereas that portion of participation after 1973 is to be reported as ordinary income.

to manually screen thousands of individuals' income tax returns to reconcile apparent pension payout reporting discrepancies because IRS had not developed effective computer matching procedures.

BETTER REPORTING AND COMPUTER MATCHING PROCEDURES COULD INCREASE TAX RECOVERY

IRS recovery procedures for unreported pension payouts have not been fully effective because (1) there is no process to verify whether employers submit required reports of pension payouts to IRS and to employees, (2) most pension payouts reported as ordinary income by employers have not been processed for computer matching with data on employee income tax returns, and (3) no payouts reported as capital gains are processed for computer matching. In addition, IRS computer matching procedures for identifying unreported pension payouts have not been effective.

IRS increased the level of pension payout reports of ordinary income used for computer matching from 21 percent in tax year 1976 to 35 percent in tax year 1978. The possibility of a full matching program in lieu of sampling has been considered by IRS, and actions have begun to implement such a program for tax year 1980 filings of pension payouts reported as ordinary income, above a certain dollar tolerance.

Inadequate reporting of pension payouts

Four IRS studies 1/ conducted between 1966 and 1974 showed that many employers and other payers are not filing required forms to report miscellaneous income to taxpayers, such as interest, dividends, and pension payouts. Nonreporting rate estimates made in these IRS studies for miscellaneous income ranged from 19 to 42 percent. A more recent study by IRS 2/ of a random sample of about 50,000 taxpayers found that, of those taxpayers receiving pension payouts, about 16 percent said their employer had not provided them with the necessary IRS form for reporting the pension

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1/The IRS studies were conducted as part of IRS' continuing reviews of tax reporting and included efforts to identify compliance problems with reporting of miscellaneous income items.

2/An IRS study completed in 1980 included a survey of about 50,000 randomly selected taxpayers for audits of their 1976 income tax filings. The audits consisted of interviews between April 1977 and March 1979 with the taxpayers and reviews of taxpayers records to obtain responses to about 160 tax-related questions. Three questions were directed at pension payouts, and IRS indicates that projections can be made to about one-half the universe of participants receiving pension payouts for tax year 1976.

payout. An IRS official participating in administering the study told us that a review of employers' records to ensure proper filing for employees indicating they did not receive a form for their pension payout was not within the study scope. He indicated that, when employees do not receive their copies of the pension payout report form, there is a strong likelihood that (1) IRS may not have received its copy of the report and (2) the employee may not be aware that the pension payouts are to be reported as income for tax purposes.

Annual reports submitted by pension plan administrators to IRS could be revised to summarize the number of participants receiving payouts for the reporting year and the dollar amount of payouts made. The total number of payouts made could be compared with employer summary miscellaneous income reports, 1/ which include the number of pension payouts made by the employers for like years. Comparison by computer of the annual report data filed with IRS by plans and employer reports of individuals receiving pension payouts could provide a useful method for IRS to identify employers that have not reported pension payments to individuals.

All reports of pension payouts are not compared with tax returns

The Congress envisioned a full document matching program when it passed the Revenue Act of 1962. The act requires payers of wages, interest, dividends, and certain other taxable income, such as pension payouts, to file information returns showing the amounts paid and the payees. In 1976, the Subcommittee on Commerce, Consumer and Monetary Affairs of the House Committee on Government Operations recommended that IRS achieve a full document matching program by 1980.

While IRS has made advances each year since tax year 1976 in the number of pension payout documents processed for tax compliance, about two-thirds of those received--predominately paper reports--were not being processed. Pension payouts are one-time payouts unlike other possible recurring miscellaneous income items, such as interest and dividends. If they are not subject to IRS computer matching for the year they are received, there is little likelihood they would ever be identified at a later date.

IRS receives employer pension payout reports predominately in paper form that must be converted to computer form for matching

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1/Employers making payments of miscellaneous income to employees above certain dollar tolerance levels are required to notify IRS of these payments on required forms. In addition, the employers are to submit to IRS summary reports showing the number of miscellaneous income forms being submitted.

with data reported on individual income tax returns. About 15 percent of the employer reports of pension payouts for tax year 1978 were provided to IRS on computer magnetic media--all of which is processed for matching. Increases in this type of reporting over the 2 preceding tax years has contributed to IRS' ability to increase from 21 to 35 percent, the proportion of pension payout reports of ordinary income that were processed for computer matching for tax compliance. 1/

For tax year 1976, the latest year complete pension payout data were available, IRS compared ordinary income reported on about 471,000 (or about 21 percent) of the employer reports they received on pension payouts with the income reported on the individuals' income tax returns. Income reported as capital gains by employers was not compared by IRS with individuals' tax returns. IRS' evaluation of tax returns resulted in 14,825 individuals agreeing that they underreported pension payout income for $4.3 million in assessed taxes, penalties, and interest due from taxpayers that had not reinvested their payouts in other qualified pension plans. If IRS had reviewed all pension payouts reported by employers in tax year 1976, we estimate at least an additional $9.6 million in tax revenues could have been recovered.

Our estimate of $9.6 million in additional tax recoveries was based on projections using IRS data. Our methodology and calculations were confirmed with a responsible IRS official, and the resulting estimate is considered conservative because it excludes (1) certain tax recoveries from pension payouts which IRS aggregates for reporting purposes with other tax recoveries and (2) potential recoveries from capital gain payouts that IRS does not compare with individual tax returns. Among the exclusions were pension payouts received by over 25,000 individuals that were identified from computer records as not having filed income tax returns and were examined separately by IRS. Subsequent recoveries from these individuals for underreporting of pension payouts were not separable from other IRS tax recoveries.

It has been IRS' practice to select a random sample of employer reports of pension payouts for processing and destroy the other forms shortly after the selection. Thus, IRS cannot go back and review pension payouts excluded from samples it has taken for prior tax years. Samples have been selected and unprocessed forms have been destroyed through tax year 1979. Based on its cost experience in identifying unreported ordinary income pension payouts

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1/Many of the documents that enter the processing cycle for matching purposes are not matched for such reasons as the pension payout is below the dollar tolerance level or they cannot be processed because of identification problems.

for tax year 1976, our analysis shows IRS made over $11 in tax assessments for each dollar of its expenses. 1/ As of May 1981, data were not yet available on IRS tax assessments from pension payouts beyond tax year 1976.

IRS has begun to compare all employer reports of pension payouts, above certain dollar tolerance levels, as ordinary income with individual income tax returns for tax year 1980. However, if potential tax recoveries are to be maximized, employer reports of pension payouts as capital gains should also be matched. This is a major category of pension payout reporting that IRS requires of employers, but it does not transcribe such income for computer matching. IRS officials indicated that pension payout capital gain reporting has not been processed for tax compliance because of possible complexities in computer matching to individual income tax returns. IRS officials have not determined the total value of employer pension payouts reported as capital gains that IRS has received, although they agree with us that such income could equal or exceed the $6 billion of pension payouts reported as ordinary income during tax year 1976.

Ineffective computer matching procedures for tax compliance

Employers are required to advise recipients of pension payouts whether distributed amounts can be treated as ordinary income or capital gains. (See app. II.) The employer also reports this information to IRS. Employees are required to report pension payouts on their income tax returns as (1) rolled over into an individual retirement account, (2) ordinary income, (3) capital gain, or (4) treatment under special income averaging tax provisions. In making the computer match for pension payouts tax compliance, IRS compares only employer reports of ordinary income with income reported in the employees income tax return. When dollar amounts do not coincide, information from other potential reporting areas on individuals' tax returns must be manually reviewed by IRS to determine if the pension payout was properly reported.

Although 87,483 individuals were identified as potential underreporters of pension payout income for tax year 1976, 54,749 were not sent notices of when taxes were due and IRS had no record of why notices were not sent. IRS officials believed that a

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1/The ratio of expenses to tax assessments was developed from IRS data using the number of cases processed for tax year 1976. Average cost per case was estimated for each processing step from receipt of pension payout reports to case closing or case referral for examination. Our analysis was confirmed by IRS officials.

primary reason notices were not sent was that manual review disclosed reporting of the payment elsewhere on individuals' tax returns. Transcribing information for computer matching from other pension payout reporting areas on employer reports and individual income tax returns could be a more effective method for identifying unreported pension payouts. Information reported by individual taxpayers of payout rollovers is already transcribed by IRS and could be used for computer matching.

AGENCY ACTIONS AND OUR CONCLUSIONS

We discussed our findings and the need to improve the oversight of pension payouts with IRS headquarters officials. In January 1981, the IRS Assistant Commissioner for Compliance proposed improvements for the information returns programs. He indicated that, since 1974, an IRS priority has been to move toward a full matching program for information returns by encouraging the use of computer magnetic tape reporting and increasing the number of paper reports processed for compliance.

The Assistant Commissioner suggested consideration of 100-percent matching above specified dollar levels of certain miscellaneous income reporting forms including those for pension payouts against individual income tax returns. Regarding employer reports of pension payouts, the Assistant Commissioner noted that these payments represent one-time payments where compliance is best obtained by a 100-percent review. He indicated that implementation could begin in 1982 for tax year 1981 filings.

In February 1981, however, IRS decided to process all reports above certain dollar tolerance levels of selected miscellaneous income items, including pension payouts reported as ordinary income. The changes became effective immediately to improve tax compliance efforts. However, they do not provide for matching pension payouts reported by employers as capital gains. Although IRS has made significant progress in matching all payouts reported as ordinary income, it has not assessed the advantages of comparing, for tax compliance, data on pension payouts reported as capital gains. If such comparisons are not advantageous, then there would appear to be little merit to requiring continued accumulation and reporting of such data by employers.

RECOMMENDATIONS TO THE COMMISSIONER OF *INTERNAL REVENUE*

To improve the oversight of pension payouts and income tax revenue recovery, we recommend that the Commissioner:

--Determine for tax year 1982 the amount of pension payouts reported by employers as capital gains to employees and whether an effective method to compare such reporting with individual tax returns can be developed. If an effective comparison method cannot be developed, discontinue the employer reporting requirements of pension payouts as capital gains.

--Use relevant reporting areas on individual tax returns, such as a reported rollover for computer matching with employer pension payout reports to alleviate the need for manual reviews.

--Develop procedures for testing employers' filing compliance on pension payouts by obtaining on pension plan annual reports, summary information on the number of payouts made above established dollar tolerences during the year to be compared with employer summary miscellaneous income reports.

AGENCY COMMENTS AND OUR EVALUATION

IRS officials told us that they agreed generally with our recommendations. To alleviate the need for manual reviews to determine taxpayer compliance with pension payouts, IRS plans for tax year 1980 to improve the quality of computer matching of pension payouts for ordinary income. In addition, IRS plans on developing procedures, such as a payer master file, to test and assure employer filing compliance on pension payouts. (See app. IV, pp. 49 and 50.)

IRS stated that it could not begin implementing our recommendation to determine the amount of pension plan payouts reported by employers as capital gains until 1982 and that they would not be able to establish an effective method for matching such reports with individuals' tax returns until tax year 1985 because of revisions needed in taxpayer reporting requirements and computer matching techniques. Pending completion of these efforts IRS does not plan to recommend deletion of the employer reporting requirements concerning capital gains distributions. (See app. IV, p. 49.) Based on IRS comments, we modified our recommendation to allow IRS to assess the level of pension payouts reported as capital gains for tax year 1982. 1/ The additional time provided should permit IRS to implement our recommendation.

1/The recommendation in our draft report provided for IRS to determine the level of pension payments reported as capital gains for tax year 1980.

 APPENDIX I

FORM 5310--USED BY PLAN SPONSORS TO OBTAIN AN IRS DETERMINATION UPON TERMINATION

Form **5310** (Rev. March 1978) Department of the Treasury Internal Revenue Service

Application for Determination Upon Termination

Notice of Merger, Consolidation or Transfer of Plan Assets or Liabilities

(Under sections 401(a) and 6058(b) of the Internal Revenue Code of 1954)

For IRS Use Only
Case number ▶
Issue date ▶
EPMF status code ▶
File folder number ▶

Please complete all items in Part I and all the items in either Part II, III or Schedule A, whichever is applicable to you. If any item does not apply enter "N/A."

Reason for filing (check one box only):
A ☐ Notice of plan merger, consolidation or transfer of plan assets or liabilities—Complete Parts I and II
B ☐ Application for a determination letter regarding a plan termination—Complete Parts I, III and Schedule A

Part I

1 (a) Name of employer or association of employers or employees
Address (number and street)
City or town, State and ZIP code | Employer's telephone number ( )
(b) Name of plan administrator if other than person(s) named in 1(a) above
Address (number and street)
City or town, State and ZIP code
(c) Administrator's employer identification number ▶ (d) Telephone number ▶ ( )

2 Employer identification number
3 Business code number
4 Date incorporated or business commenced
5 Employer's taxable year ends

6 Check appropriate box(es) to indicate type of plan entity:
(a) ☐ Single employer plan
(b) ☐ Plan of controlled group of corporations or commonly controlled employers
(c) ☐ Multiemployer plan
(d) ☐ Other multiple employer plan
(e) ☐ Keogh (HR 10) plan

7 (a) Plan name | (b) Plan number | (c) Plan year ends

Part II To be Completed ONLY for a Plan Merger or Consolidation or Transfer of Plan Assets or Liabilities to Another Plan

8 Other plan(s): (a) Plan name | (b) Name of employer
(c) Employer identification number | (d) Plan number | (e) Date of merger, consolidation or transfer

(f) In the case of a defined benefit plan attach an actuarial statement of valuation evidencing compliance with the requirements of section 401(a)(12) of the Code. (See also section 414(l) of the Code.)

Part III

9 Type of plan (check appropriate box):
(a) ☐ Defined benefit
(b) ☐ Money purchase
(c) ☐ Profit-sharing
(d) ☐ Other (specify) ▶

10 Effective date of plan | 11 Date and file folder number of last determination letter | 12 Proposed date of termination

13 Reason for termination (check applicable box):
(a) ☐ Change in ownership by merger
(b) ☐ Liquidation or dissolution of employer
(c) ☐ Change in ownership by sale or transfer
(d) ☐ Adverse business conditions (see instructions)
(e) ☐ Adoption of new, superseding plan
(f) ☐ Other (specify) ▶

14 Type of funding (check appropriate box(es)):
(a) ☐ Trust or custodial account
(b) ☐ Fully insured (non-trusteed)
(c) ☐ Other (specify) ▶

Under penalties of perjury, I declare that I have examined this application, including accompanying statements, and to the best of my knowledge and belief it is true, correct and complete.

Signature ▶ Title ▶ Date ▶

Signature ▶ Title ▶ Date ▶

Form 5310 (Rev. 3-78)

15 (a) Name of trustee or custodian (If none, enter "N/A" in 15(a) and (b))	(b) Date accounting period ends
Address (number and street)	
City or town, State and ZIP code	

16 Number of active employee participants for current plan year and each of the five prior plan years:

Item	19........	19........	19........	19........	19........	19........ (current year)
(a) Beginning of year						
(b) Added during the year						
(c) Total of lines (a) and (b)						
(d) Dropped during the year						
(e) Total end of year, (c) less (d)						

17 Summary of distributable benefits from terminated plan:

Category of participant or claimant	Total number	Amount distributed or distributable upon termination
(a) Retirees and beneficiaries (including disability retirees)		
(b) Eligible for normal retirement		
(c) Eligible for early (but not normal) retirement		
(d) Vested prior to termination (other than normal or early retirement)		
(e) Former employees with vested deferred benefits		
(f) All other active participants		
(g) Total, add lines (a) through (f)		
(h) Net amount, if any, returned or to be returned to employer		

18 Miscellaneous:	Yes	No
(a) Has each employee who qualifies as an interested party been informed of the filing of this application?		
(b) Have benefits been liberalized in the 60 months prior to termination?		
(c) Will the trust continue to operate after termination of the plan?		
(d) Were any funds contributed in the form of, or invested in, obligations or property of the employer or any controlled corporation?		
(e) Will distributions include property other than cash?		
(f) Will distributions to owner-employees be made prior to age 59½?		
(g) Will any funds revert to or become available to the employer?		
(h) Is any issue relating to this plan, or trust, currently pending before ☐ the Internal Revenue Service, ☐ the Department of Labor, ☐ the Pension Benefit Guaranty Corporation, or ☐ any court? If "Yes," check box above to indicate where issue is pending		

19 If a defined contribution plan, other than a money purchase pension plan, enter forfeiture information as follows:	
(a) Total forfeitures for all plan years	
(b) Percent of total forfeitures to total contributions for all plan years	%
(c) Explain basis on which forfeitures were allocated ►	

20 Indicate how distributions will be made:

(a) ☐ Lump-sum
(b) ☐ Annuity
(c) ☐ Periodic payments from trust
(d) ☐ Transfer of assets and liabilities to another plan
(e) ☐ Other (specify) ►

21 Trust balance sheet (complete only if trusteed). Show figures as of termination date. (If advance determination is being requested see instructions.)

Assets	Current value	Liabilities and Reserves	Current value
Cash		Accounts and notes payable to:	
Bonds and debentures: (a) Governmental		(a) Employer	
(b) Foreign		(b) Others	
(c) Nongovernmental		Mortgages payable	
Stock: (a) Employer		Accrued expenses	
(b) Other			
Loans to: (a) Employer		Other liabilities	
(b) Party in interest			
(c) Others		Total liabilities	
Real estate loans and mortgages		Reserves (total assets less total liabilities)	
Real estate (net)			
Other assets			
Total assets		Total liabilities and reserves	

Form 5310 (Rev. 3-76)

Sched. A — Distributable Benefits to Individual Participants

Note: *This schedule is NOT open to public inspection*

Name of employer ▶

Employer identification number ▶

(Money amounts should be in whole dollars)

Line no.	Participant's last name and initials (list in order of compensation)	Check applicable columns: Officer/shareholder	Owner-employee	Other self-employed	Other employee	Benefits fully vested before termination	Fill in columns: Years of participation	Age at termination	Percent of business owned (1% or more)	Compensation: Current 12 month period ending on date of termination or proposed date of termination	Compensation: For all full years of participation or for last ten years, whichever is lesser	Amount of employer contributions distributed or proposed to be distributed as of plan termination date. Defined contribution plans list allocations in column (A). Defined benefit plan see note * below. (l)		Defined contribution plans other than money purchase pension plans only: Forfeitures for all full years of service or for last ten years, whichever is lesser	Percent of benefit to total compensation or ten years compensation (l) divided by (k)
	(a)	(b)	(c)	(d)	(e)	(f)	(g)	(h)	(i)	(j)	(k)	(A)	(B)	(m)	(n)
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23															
24															
25															
26	Totals for above														
27	Totals for all others														
28	Totals for lines 26 and 27														

* Defined benefit plans list amounts allocated in accordance with section 4044(a)(1), (2), (3) and (4)(A) of the Employee Retirement Income Security Act of 1974 under column (l)(A), and list under column (l)(B) all other allocated amounts.

EXAMPLES OF COMPLETED FORMS 1099R

AS PROVIDED IN IRS TAX INSTRUCTIONS

Statement for Recipients of 1980
Total Distributions from Profit-Sharing, Retirement Plans and Individual Retirement Arrangements
Copy B For Recipient

XYZ Corporation Employees' Pension Plan
1111 Constitution Avenue
New York, New York 11101
49-1111100

Type or print PAYER'S name, address, ZIP code, and Federal identifying number

Recipient's identifying number	1 Amount includible as income (Add boxes 2, 3, and 4)	2 Capital gain (For lump-sum distributions only)	3 Ordinary income	4 Premiums paid by trustee or custodian for current insurance
123-45-6789	58,000	52,000	6,000	
5 Employee contributions to profit-sharing or retirement plans	**6 Amount of IRA distributions (do not include box 4 amounts)**	**7 Category of distribution**	**8 Net unrealized appreciation in employer's securities**	**9 Other:**
12,000				$ %

This does [X] does not [ ] qualify as a lump-sum distribution.
Your percentage of total distribution. ▶ 100 %
Death benefit exclusion does [ ] or does not [X] apply.

Robert C. Smith
911 Mill Way
Home Town, New York 11103

Type or print RECIPIENT'S name, address, and ZIP code above.

This information is being furnished to the Internal Revenue Service.

Form 1099R Department of the Treasury—Internal Revenue Service

Statement for Recipients of 1980
Total Distributions from Profit-Sharing, Retirement Plans and Individual Retirement Arrangements
Copy B For Recipient

Brown's Real Estate Profit-Sharing Plan
2101 Chelsea Court
Anytown, California 96503
94-9999999

Type or print PAYER'S name, address, ZIP code, and Federal identifying number

Recipient's identifying number	1 Amount includible as income (Add boxes 2, 3, and 4)	2 Capital gain (For lump-sum distributions only)	3 Ordinary income	4 Premiums paid by trustee or custodian for current insurance
987-65-4321	33,000	29,000	4,000	
5 Employee contributions to profit-sharing or retirement plans	**6 Amount of IRA distributions (do not include box 4 amounts)**	**7 Category of distribution**	**8 Net unrealized appreciation in employer's securities**	**9 Other:** Annuity Contract
				$10,000 %

This does [X] does not [ ] qualify as a lump-sum distribution.
Your percentage of total distribution. ▶ 100 %
Death benefit exclusion does [ ] or does not [X] apply.

Mary Brown
12 Mill Avenue
Hometown, California 90302

Type or print RECIPIENT'S name, address, and ZIP code above.

This information is being furnished to the Internal Revenue Service.

Form 1099R Department of the Treasury—Internal Revenue Service

Pension Benefit Guaranty Corporation
2020 K Street, N.W. Washington, D.C. 20006

September 8, 1981

Mr. Gregory J. Ahart
Director
Human Resources Division
General Accounting Office
Washington, DC 20548

Dear Mr. Ahart:

This is in reply to your letter of August 5, 1981 regarding your draft report entitled "Millions of Dollars of Tax Revenues Lost and Beneficiaries Inadequately Protected When Private Pension Plans Terminate."

The report is primarily addressed to matters involving the Internal Revenue Service. We do, however, concur fully in the report's two recommendations concerning PBGC which state that:

1. PBGC, in cooperation with IRS, should use the automated records of both agencies to identify non-reporters of plan terminations; and

2. PBGC should establish procedures for timely follow-up with the potential non-reporters to ensure that participants in terminated plans, entitled to retirement benefit insurance, are afforded the protection intended by the Congress under ERISA.

The fact that a number of plans covered by Title IV may be terminated without being reported to PBGC has been a matter of great concern to us. Accordingly, we have actively pursued various methods to identify such situations, and have endeavored to assess the feasibility and effectiveness of each available approach.

For example, PBGC manually matched a sampling of its records of terminations with Form 5310's received by IRS from defined

benefit plans requesting tax qualification determinations upon termination. Since filing of Form 5310 with IRS is not mandatory, the results we obtained from the sample were indicative only of noncompliance with Title IV requirements by those plans which voluntarily file with IRS. In this connection, IRS and PBGC have been designing a "One-Stop Shopping" program whereby any terminated plan covered by Title IV and requesting a tax qualification determination would be required to file the Form 5310 with PBGC, which would forward a copy to IRS. The Form 5310 would be expanded to include Title IV filing requirements as well as all IRS requirements. Implementation of this program should eliminate for the future most of the disparity between Title IV plan terminations reported to IRS for tax qualification purposes and those reported to PBGC.

More recently we have begun a program of matching IRS's computer records of plans which have indicated termination on the Form 5500 annual report with PBGC's computer records of terminated plans, and this effort is now well underway. Considerable planning and inter-agency involvement have gone into this program, which we believe will be especially useful because it is mandatory that the Form 5500 annual report be filed. Thus, a broader universe of plans is included in the computer record of Form 5500 filings than is included, for example, in the record of Form 5310 voluntary filings. As your report makes clear, any such matching program is handicapped by the fact that many plan sponsors erroneously use different employer identification numbers (EIN's) in their various filings. We are attempting to minimize this problem by seeing to it that the EIN entered into our computer record for each terminated plan corresponds with the EIN used in that plan's most recent Form 5500 filing.

Subsequent to the time referred to in the discussion of this program contained in your draft report (May 1981), letters have been generated by computer to 741 potential terminated plan sponsors who appeared not to have filed with PBGC. Preliminary results show that in many of these instances the plan was not covered by Title IV, or had never really terminated, or had actually filed with PBGC under different identification. We will continue to pursue this Form 5500 matching program -- at least to the point at which reliable assessments can be made as to its effectiveness -- and we will be pleased to keep you informed of the results.

We strongly believe that a combination of:

(1) the recommendations to PBGC in your report, including implementation of our Form 5500 computer matching program, together with

(2) the IRS/PBGC "One-Stop Shopping" program, and

(3) GAO's recommendation that the Internal Revenue Code be amended to make tax qualification determination filing with IRS mandatory,

will provide a significant measure of assurance that both agencies receive substantially complete reporting of plans upon termination.

We wish to thank GAO for the opportunity to provide comment on this report and especially for the opportunity for many helpful discussions with the GAO staff.

Sincerely,

Robert E. Nagle

Robert E. Nagle
Executive Director

APPENDIX IV

COMMISSIONER OF INTERNAL REVENUE
Washington, DC 20224

SEP 8 1981

Mr. William J. Anderson
Director, General Government Division
United States General Accounting Office
Washington, D.C. 20548

Dear Mr. Anderson:

I appreciate the opportunity to review your draft report entitled "Millions of Dollars of Tax Revenues Lost and Beneficiaries Inadequately Protected When Private Pension Plans Terminate." I have enclosed our specific comments on each of the recommendations contained in your report.

With kind regards,

Sincerely,

Roscoe Egger

Enclosure

GAO note: The page references in this appendix may not correspond to the page numbers in the final report.

IRS COMMENTS ON GAO RECOMMENDATIONS IN DRAFT REPORT ENTITLED "MILLIONS OF DOLLARS OF TAX REVENUES LOST AND BENEFICIARIES INADEQUATELY PROTECTED WHEN PRIVATE PENSION PLANS TERMINATE"

Page 27, Recommendations 1, 2, and 3

We recommend that the Commissioner:

1. Establish quality control procedures to ensure that termination applications approved contain all necessary data for making such determinations.

2. Establish a level of turnover for reviewers to use in questioning participant departures before plan termination.

3. Identify documentation for reviewers to obtain when questioning possible discriminatory vesting, participant forfeitures and questionable benefit distributions.

Comments

For some time the Service has been working to improve the review of plan terminations. As indicated in the draft report, the Service has already developed a training course for Employee Plans specialists that covers the review of terminating plans. In addition, we have developed a detailed Plan Termination Standards Worksheet that is to be completed on each case, and have provided each specialist with a detailed explanation to assist in identifying terminating plan problems.

The Service is now developing a Terminations Handbook which will serve as a single source document for use by Employee Plans specialists when reviewing plan terminations, both during the determination process as well as the examination process. Included in the Handbook will be the Plan Termination Standards Worksheet and Explanation. Further, the Handbook will identify what the specialist should do when information provided by pension plans requesting an IRS determination is incomplete or inconsistent and what additional supporting documentation (including that related to possible discriminatory

vesting, participant forfeitures and questionable benefit distributions) should be obtained when questionable actions of plan sponsors are identified. Other guidelines that the Handbook will specifically address are:

1. When an examination should be initiated based upon the review of the determination application;
2. Establishment of a meaningful level of turnover above which specialists must question participant departures prior to plan termination;
3. Development of a procedure to secure additional information from third-party contacts, including terminated participants, to verify information submitted with the termination application;
4) Reconciliation of discrepancies between plan assets and participants' distributions; and,
5) Identification of discriminatory distributions.

We expect to have this Handbook available for distribution to our field personnel by March 31, 1982.

Effective January 1, 1982, all termination cases processed by an Employee Plans specialist will be given a second level of review by the Technical Staff. These reviews will include both determination applications and examinations. Additionally, the FY 1982 field workplans will require increased emphasis on the examination of terminated plans to assure compliance with all qualification requirements especially those relating to employee benefits.

Page 43, Recommendation 4

We recommend the Executive Director of PBGC, in cooperation with the Commissioner of IRS, use Federal automated records to identify nonreporters of plan terminations. We also recommend that the Executive Director of PBGC establish procedures for timely followup with the potential nonreporters to ensure participants in terminated plans, entitled to retirement benefit insurance, are afforded the protection intended by the Congress under ERISA.

Comments

We generally agree with this recommendation, and representatives of our Employee Plans Division will contact PBGC to discuss the feasibility of its implementation.

Page 54, Recommendation 5

Determine for tax year 1980 the amount of pension payouts reported by employers as capital gains to employees and whether an effective method to compare such reporting with individual tax returns can be developed. If an effective comparison method cannot be developed, discontinue the employer reporting requirements of pension payouts as capital gains.

Comments

IRS cannot determine the amount of pension payouts reported as capital gains for 1980 since the information returns, Forms 1099R, for Tax Year 1980 have already been processed. Development of Tax Year 1981 computer programs is complete. Therefore, Tax Year 1982 is the earliest we could determine the amount of pension payouts reported by employers as capital gains to the employees.

However, certain Form 1040 revisions must be achieved, along with revisions to our matching technique, to utilize transaction tapes containing tax return data, rather than master file summary tax data. We anticipate that the earliest this will occur is for Tax Year 1985 processing.

Pending consideration and final determination of revised matching criteria, we do not recommend amendments to existing reporting requirements concerning capital gain distributions arising from pension plan liquidations.

Page 54, Recommendation 6

Utilize relevant reporting areas on individual tax returns such as a reported rollover for computer matching with employer pension payout reports to alleviate the need for manual reviews.

Comments

The necessity for manual reviews will be lessened to the extent that computer matching can be made more accurate, i.e., reducing apparent discrepancies which must be manually screened. Revisions to the 1981 Individual Income Tax Returns and instructions should help to improve the quality of computer matching of pension payouts for ordinary income. For Tax Year 1980 we will match the sum of ordinary pension payouts from Form 1099R plus gross pensions and annuities from Form W-2P against the sum of gross ordinary income from pension payouts plus pensions and annuities, prior to exclusions due to rollover or recovery. This should reduce the number of apparent discrepancies.

Page 54, Recommendation 7

Develop procedures for testing employers' filing compliance on pension payments by obtaining on pension plan annual reports summary information on the number of payments made above established dollar tolerances during the year to be compared with employer summary miscellaneous income reports.

Comments

The Service agrees that it would be useful to test and assure filing compliance related to pension payments. We are currently considering development of a payer master file which would facilitate this. This file would 1) contain information return filing requirements; 2) perform systematic delinquency checks on nonfiling payers; and 3) generate inquiries where payer filing patterns change drastically in terms of numbers of information returns, amounts paid, and type of payment. This file would include payers in the private sector, as well as federal, state, and local government agencies.

As currently conceived, the payer, or source, master file would utilize data from a number of sources. Among these are Forms 1096, Annual Summary and Transmittal of U.S. Information Returns; Form 1099, information returns, filed by payers or transmitters for payers; correspondence inquiries; other master files, and miscellaneous forms such as SS-4, Application for Employer Identification Number; and Form 5500, Annual Return/Report of Employee Benefit Plan.

Development of the payer master file will be explored concurrently with development and implementation of the Equipment Replacement Program tentatively scheduled for completion in the mid 1980's.

Page 43, Recommendation to the Congress

The Congress should enact legislation requiring plan sponsors to request an IRS determination for tax qualification of terminating pension plans before plan dissolution.

Comments

We are in general agreement with the proposal since many plans terminate without requesting a determination of qualification, with the result that participants' benefits may not be protected as provided under ERISA. While the Office of the Secretary has responsibility for review of legislative proposals, we think that the proposed 60 day time frame should be extended to a minimum of 90 days. This would permit sufficient time for the Service to consider any interested party comments generated as a result of the determination application. It is noted that the proposed language would not prevent the distribution of plan assets after a determination request is made but before the Service completes its review. Any legislation in this area should also reflect the needs of the Pension Benefit Guaranty Corporation.

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